Rev. Rul. 79-313

1979-2 C.B. 75

Section 104

IRS Headnote

Disability benefits; payments increased yearly. A taxpayer received payments for personal injury in settlement with an insurance company as a result of an accident. The insurance company agreed to make fifty consecutive annual payments, each of which would be increased by five percent a year. The entire amount of the payments received is excludable from gross income under section 104(a)(2) of the Code.

Full Text

Rev. Rul. 79-313

ISSUE

Are payments received by the taxpayer, under the circumstances described below, excludable from the gross income of the taxpayer under section 104(a)(2) of the Internal Revenue Code?

FACTS

In 1977, the taxpayer sustained severe and permanent personal injuries as the result of being struck by an automobile. Thereafter, the taxpayer brought an action against X, the owner-operator of the automobile. X carried automobile liability insurance with M, an insurance company.

In 1979, M proposed a settlement of taxpayer's suit against X, which the taxpayer accepted. Pursuant to the settlement agreement, M agreed to make fifty consecutive annual payments to the taxpayer, the first payment to be made one year after the date of settlement. These payments are for "personal injury, pain and suffering, disability, and loss of bodily function." The amount of each annual payment will be increased by five percent over the amount of the preceding annual payment.

The settlement also provides that the taxpayer does not have the right to accelerate any payment or increase or decrease the amount of the annual payments specified.

Under the agreement, M is not required to set aside specific assets to secure any part of its obligation to the taxpayer. The taxpayer's rights against M are no greater than those of M's general creditors. M's obligations to the taxpayer result solely from the settlement out of court of the legal action that the taxpayer instituted against X who was insured by M.

LAW AND ANALYSIS

Section 104(a)(2) of the Code provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 for any prior taxable year, gross income does not include the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness.

Section 1.104-1(c) of the Income Tax Regulations provides that the term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

The annual payments to be received by the taxpayer are amounts received through a settlement agreement entered into in lieu of the prosecution of a legal suit based upon tort or tort rights within the meaning of section 1.104-1(c) of the regulations.

Rev. Rul. 65-29, 1965-1 C.B. 59, holds that, when the taxpayer actually received the present value of an award for personal injury in a lump sum and invested it, any interest earned on the amount invested was taxable. However, in the instant case, even though the settlement agreement provides for increasing payments to be made annually the taxpayer has neither actual nor constructive receipt, nor the economic benefit of the present value of the damages.

HOLDING

All payments received by the taxpayer in this case, pursuant to the settlement agreement, are excludable from the gross income of the taxpayer under section 104(a)(2) of the Code.